

# Applicability of Accounting Standard (AS) 18, 'Related Party Disclosures'

*The following is the brief version of an opinion given by the Expert Advisory Committee of the Institute in response to query sent by a member. This is being published for the information of readers.*

## A. Facts of the Case

**1** A company, registered under the provisions of the Companies Act, 1956, is promoted by the Government of Tamil Nadu. It is primarily engaged in the business of manufacture of newsprint, printing and writing paper using bagasse as a basic raw material. The Government of Tamil Nadu (GOTN) and Industrial Development Bank of India (IDBI) are the two major shareholders of the company holding 35.10% and 34.30% of the equity share capital of the company respectively. As per the querist, it is not a government company but is deemed to be a government company under section 619B of the Companies Act, 1956.

**2** The querist has stated that the Board consists of 12 directors out of which 3 directors are nominees of GOTN and 2 directors are nominees of IDBI. Besides, the Chairman and Managing Director is appointed by GOTN. Two working directors, viz., Director (Finance) and Director (Operations) are appointed by the company, and the others are independent non-executive directors appointed by the company. Other than GOTN and IDBI, no other body corporate or individual holds substantial voting power in the company.

**3** According to the querist, the company is having business dealings with some of the State-owned

departments/agencies and banking relationship with IDBI Bank and IDBI Mutual Fund. During the course of audit for the accounting year ended March 31, 2002, the statutory auditors observed that as IDBI is holding substantial portion of the share capital of the company and its nominees are on the Board, it can exercise significant influence in making financial and operating decisions, and, therefore, insisted that the company has to comply with the disclosure requirements under Accounting Standard (AS) 18, 'Related Party Disclosures', issued by the Institute of Chartered Accountants of India, in respect of related party transactions.

**4** The company informed the auditors that AS 18 is not applicable to the company. The reasons put forth by the company as well as by the statutory auditors in support of their views are summarised below:

### Company's views

The reporting enterprises having transactions with government departments and government agencies including government sponsored bodies and other entities are covered under paragraph 4(c)(iv) of AS 18, and, therefore, are excluded from the definition of 'related party'. Such entities are *deemed* not to be related parties. In other words, such exempted categories by virtue of their normal dealings with an enterprise can not be construed as related parties notwithstanding that the parties listed under paragraph 4(c)(iv) may circumscribe the freedom of action of the enterprise or participate in its decision making process.

As far as IDBI is concerned, though it has voting power of more than 20%, it does not have power to direct the financial and operating policies of the company. Besides, IDBI also falls under the exempted category (paragraph 4(c)(iv) of AS 18) as it is a body con-

*1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.*

*2. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in 22nd volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.*

stituted by the Central Government under a special Act of Parliament wherein 60% of its equity is held by the Central Government.

Having regard to the above, no specific disclosure is required under AS 18 in relation to transactions with GOTN and IDBI.

### Statutory auditor's views

The statutory auditors are in agreement with the company regarding non-applicability of AS 18 with reference to transactions with GOTN departments and Government agencies. But they differ with the company regarding transactions with IDBI. They are of the view that though IDBI does not have a controlling stake in the company, it has voting power of more than 20% by virtue of which they can exercise significant influence in making financial and operating decisions. Though IDBI does not have the ability to control the financial and operating policies, they do participate in the decision making of such policies. Notwithstanding the above, IDBI cannot be brought under the exempted categories specified in paragraph 4(c)(iv) of AS 18 especially of 'government departments and government agencies including government sponsored bodies' since IDBI also has voting power of more than 20% of the company. Hence, IDBI does not fall under the exempted category listed in paragraph 4(c)(iv) of AS 18. As such, the statutory auditors advised the company to comply with AS 18.

### B. Query

**5** The querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (a) Whether IDBI can be brought within the scope of 'government departments and government agencies including government sponsored bodies' (paragraph 4(c)(iv) of AS 18) and thereby treat IDBI as deemed not to be a 'related party'.
- (b) Whether the company can be considered as 'State-controlled enterprise' (defined in AS 18), for the limited purpose of ascertaining the applicability of AS 18, in the light of the fact that IDBI (under the control of Central Government) and GOTN jointly hold 69% of the equity of the company and GOTN and IDBI appoint six directors including 'Chairman and Managing Director' of the company.

### C. Points considered by the Committee

**6** The Committee notes that paragraph 4 of AS 18, *inter alia*, provides as follows:

"4. In the context of this Statement, the following are deemed not to be related parties:

.....

(c) the parties listed below, in the course of their normal dealings with an enterprise *by virtue only of those dealings* (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):

- (i) providers of finance;
- (ii) trade unions;
- (iii) public utilities;
- (iv) government departments and government agencies including government sponsored bodies." (Emphasis added by the Committee.)

**7** The Committee also notes that clause 1 of Chapter 4, 'Business of the Development Bank' of the Industrial Development Bank of India Act, 1964, states, *inter alia*, as below:

"1. The Development Bank shall function as the principal financial institution for co-ordinating the working of institutions in financing, promoting or developing industry and for assisting the development of such institutions in such manner as it may deem appropriate and may carry on and transact any of the following kinds of business, namely:

....

(d) Granting loans and advances to any industrial concern or subscribing to, or purchasing, or underwriting the issue of stocks, shares, bonds or debentures of any industrial concern:

..."

**8** From the above, the Committee is of the view that the holding of shares in the company by IDBI is in the normal course of dealings of IDBI. Thus, as a 'provider of finance' and also being a body owned by the Central Government (as it owns 60 per cent share capital), IDBI is not deemed to be a related party by virtue of paragraphs 4(c)(i) and 4(c)(iv) of AS 18 reproduced above.

**9** With regard to whether the company in question

and IDBI are 'state-controlled enterprises', the Committee notes the following definitions of 'State-controlled enterprise' and 'control', given in AS 18:

***“State-controlled enterprise- an enterprise which is under the control of the Central Government and/or any State Government(s).”***

***“Control- (a) ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or  
(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or  
(c) a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.”***

**10** On the basis of the above definitions and the facts of the case, the Committee is of the view that both the company in question and IDBI are 'state-controlled enterprises'. IDBI is a 'state-controlled enterprise' because 60 per cent of its shares (therefore, presumably the voting power) are owned by the Central Government. The Company in question is a 'state-controlled enterprise' because the Central Government and GOTN together own more than half of the voting power of the company [Central Government through IDBI indirectly owns 20.58 per cent shares of the company (60 per cent of 34.30 per

cent shares held by IDBI in the company) and the GOTN holds 35.10 per cent shares in the company].

**11** The Committee further notes paragraph 9 of AS 18 which provides as stated below:

***“9. No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.”***

Accordingly, by virtue of the above quoted paragraph of AS 18 also, the company would not be required to make any disclosures in its financial statements as regards related party relationships and transactions with IDBI, which is also a 'state-controlled enterprise'.

### ***D. Opinion***

**12** On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 5 above:

- (a) IDBI is deemed not to be a related party by virtue of paragraphs 4(c)(i) and 4(c)(iv) of AS 18.
- (b) Yes, the company is a 'State-controlled enterprise' for the purposes of AS 18. Accordingly, the company would not be required to make any disclosures in its financial statements as regards related party relationships and transactions with IDBI. ■

## FOR YOUR INFORMATION

### A good Samaritan

My husband Mr T.V.G Sreenivas Rao (Membership no: 7761), who became a member of the Institute in 1965, expired on 16.10.84. Considering the irreparable loss and distress of our family, the Chartered Accountants Benevolent Fund came to our aid and extended the valuable financial help of Rs 300 per month for two years.

Now, the times have changed. I and my children are out of that difficult period. Now, reciprocating the noble gesture of the Chartered Accountants Benevolent Fund, I wish to contribute Rs 10,000 for all the members and their families who may be in distress like I was in 1984. I request you to receive my offer and bless my children.

**Smt T Savithri,  
Nizamabad**